sold, and the volume paid for out of savings, represents a good part of the recent credit expansion. But it could hardly be expected that private savings would keep pace with the phenomenal demands of the government during the World War. Certainly no opportunity was neglected to impress upon the public the fact that they should save to the limit. While the Federal Reserve Banks were conducting a campaign urging increased borrowing as one means of selling Liberty Bonds, an equally intensive campaign urging upon the people the necessity for thrift and rigid economy was being conducted by the same banks under the direction of the Liberty Loan and War Savings committees, as well as by various other government agencies. The Food Administration, for instance, was active in this regard.

Furthermore, a campaign was carried on under the direction of the Capital Issues Committee for the purpose of conserving capital, labor, materials and transportation facilities for their most effective use in the prosecution of the War. There was a local capital issues committee in each district which reported to the central committee on all applications for permission to issue securities for the purpose of financing public or private corporate expenditure. The Capital Issues Committee of the Second District, although in existence less than a year, considered formal applications for issues amounting to $2,069,000,000, besides numberless cases where no formal applications were filed notwithstanding the fact that when the Committee was first appointed, the submitting of applications covering private issues was largely voluntary.

The record of the Federal Reserve Banks during the War, in my judgment, is one of splendid achievements. They not only organized and directed the sales campaigns and handled the details of every loan, but also by the support given to the individual banks of the country made possible their hearty coöperation and guaranteed the success of every loan. It is a cause for deep gratification that the banks and the people through efficient methods and organization were able to supply the government with such unprecedented sums to meet its needs in carrying on the War. That five great loans, aggregating more than $21,000,000,000, were rapidly and successfully distributed with hardly a ripple in the financial markets, is of itself a great testimonial to the new banking system which has now been thoroughly tried and has successfully met the test.

The Assumption of Treasury Functions by the Federal Reserve Banks

By MURRAY S. WILDMAN
Stanford University

THE Independent Treasury as it functioned for three quarters of a century was an institution unique in the field of public finance. It grew out of the general demoralization of the banks which followed the panic of 1837 and the downfall of the Second Bank of the United States. When the Act of 1841 was passed, followed by the more adequate Act of 1846, the need for such legislation was real and urgent. On the theory that the establishment and

regulation of banks was a duty of the states, the care of Federal funds called for a Federal agency. When in 1863 that theory was abandoned, the justification for the subtreasuries passed away with it; but in twenty years these institutions had become rooted in our political system.

AN OUTGROWN AND OBJECTIONABLE SYSTEM

As long as a government agency is merely useless it may be left alone. The subtreasury buildings are substantial and impressive features of our cities; they housed several hundred officials and clerks, some of whom were devoted aids of the administration which they served, and it was not enough to show that the maintenance of this establishment involved a waste of money. Before the Independent Treasury could be abolished it must be shown as responsible for positive harm.

The important ground of objection to the subtreasuries was their evil influence in the money market. The harm that they did was real and substantial, although it was obscure. The great hoard of coin and bullion and legal tender notes, which was kept behind massive steel bars and approached through dismal passages between granite walls, while it impressed the tourist, would have brought dismay to the borrower of funds if he had been fully alive to his interest. It was not merely the impounding of cash that called for condemnation of the system but the recurrence of large payments as well. The alternate collection and disbursement of the revenues brought alternate contraction and expansion of the bank reserves and consequent changes in discount rates, which, in turn, disturbed the markets for staple products and securities.

The establishment of the national banking system during the Civil War should have been followed promptly by the abandonment of the Independent Treasury, but at that particular period the banking business was not popular. The needed reform must wait for another time of great financial stress, and for a reorganization of the banking system on the principle of a single national cash reserve under Federal control.

THE NEW POLICY

The legislative acts which make definite provision for the new policy are two. Section 15 of the Federal Reserve Act of December 23, 1913, provided that "the moneys held in the general fund of the Treasury . . . may be deposited in Federal Reserve Banks, which banks . . . shall act as fiscal agents of the United States . . . and disbursements may be made by checks drawn against such deposits."

The other measure is found in the General Appropriation Act of May 29, 1920, which repealed the Act of 1846 in so far as it provided for subtreasuries, and required the Secretary of the Treasury to transfer the duties of the Assistant Treasurers of the United States to the Treasurer, the mints and assay offices and to the Federal Reserve Banks.

This Act of 1920 was belated. As intimated above, the officers and the employes of the subtreasuries owed their appointments to political influences. The original intention of the framers of the Federal Reserve Act was to have the subtreasuries taken over by the Reserve Banks. But, as the bill developed out of the economic and into the political stage in Congress, discussion arose and political force was asserted. "The moneys held in the general fund of the Treasury shall be deposited" in Section 13 became "may

be deposited" and the Secretary of the Treasury held the power of decision.

After the Reserve Banks were opened and had been officially designated as fiscal agents of the government, the Treasury made comparatively little use of them. Other bank depositaries were retained and treasury funds were placed for "crop-moving purposes" as in the past.

There was naturally adverse criticism. From official sources came pleas and explanations that the subtreasuries were convenient to the public, if not indispensable to the government, and the cities where they were located had their fears aroused that they were to be deprived of something of value to them. The criticism persisted, however. In the end the matter was referred, in March, 1917, to the Bureau of Efficiency for investigation and report to Congress.

The investigation was thorough and the report, made January 26, 1918, was most competent. The report concluded as follows:

> The Bureau of Efficiency recommends the ultimate abolition of the whole subtreasury system. It believes not only that the government will save money by this change, but also that the public will in the end be better served. It will be appreciated that in making this recommendation the Bureau of Efficiency seeks only to serve the public interest. If, however, the subtreasuries are to be continued, the Bureau of Efficiency suggests the following as a minimum program:
>
> The elimination of the three subtreasuries—Baltimore, Philadelphia and Cincinnati—which are of no essential value to the system;
>
> The abolition of the post of assistant treasurer everywhere and the transfer of responsibility to the cashiers;
>
> A reduction in the amount of coin-exchange business undertaken at the subtreasuries and by the cash room of the Treasury in Washington through the charging of a fee for receiving or paying out current coin;
>
> The concentration of all the redemptions of paper currency in Washington;
>
> Scarcely less than this can be done for the good of the Treasury and the people.

The effect of the legislation of 1920 was to make mandatory what had hitherto been permissive only. But the change of policy which these acts reveal had been slowly evolved out of a long and unhappy experience in the management of both public and private funds. The realization of the proper relation between Treasury and banks has been growing through a period of many years of nominal independence. It was made clearer by every financial crisis through which the country passed that real independence was impossible. Points of contact between Treasury and banks were established for greater convenience and economy in the handling of funds, and a relation of mutual dependence was tacitly recognized.

RELATION OF TREASURER TO BANKS 1865–1913

In order to save labor to both officials and the public, the subtreasury at New York was made a member of the clearing house on the resumption of specie payments, January 1, 1879. In the latter months of the Civil War and for several years thereafter the extensive collection of internal revenue as well as the necessities of postmasters led to the designation of certain national banks as United States depositaries. When a few years later depleted bank reserves coincided with surplus revenues in the Treasury, aggravating the stringency of the money market, the government adopted the policy of designating other national banks as special depositaries of public funds. Large sums were paid into these banks for the single purpose of putting idle cash to commercial use.

From the point of view of economical use of funds, bank depositors may be

divided into two groups: those who use banks for the safe-keeping of money, and those who use banks as agencies for the collection and payment of bills. The first class is typified by the savings depositor; the second, by the commercial depositor. The customary operations of the savings bank involve the receipt and payment of cash while the customary operations of the commercial bank involve the receipt and payment of credit instruments. In the latter case, cash is required only for a reserve, and this reserve is only occasionally brought into use. The result is that payments in and out of the commercial bank may vastly exceed the amount of cash employed. The public advantage in the use of this bank lies in the fact that a given amount of cash, when used as a reserve against deposits or notes, will accomplish much more than when used in payment directly.

In its use of national or state banks as public depositaries the Treasury never assumed the rôle of a commercial depositor in the sense here described. Funds were placed in the custody of the banks and in due course were ordered to be remitted to the Treasury. Ordinary disbursements were made by warrants drawn on the Treasurer and not by checks drawn on the banks. These so-called deposits were in reality loans to the banks in so far as the special depositaries were concerned. The banks held the funds for a definite period, paid interest on them and gave security for them. The term "deposit" was a misnomer and the practice of placing funds with the special depositaries could not be carried out without calling forth the charge of favoritism. The attitude of the public toward the banks selected to act as regular depositaries was somewhat different. These were chosen to serve the convenience of the government, but even here special collateral security was exacted and the relation of bank and depositor was not a normal one. There were no true active checking accounts maintained by the Treasury.

SITUATION 1913–1916

When the Federal Reserve Act was passed in 1913 there were 850 regular depositaries and 685 special depositaries, together holding \$76,000,000, and all of the subtreasuries except the one at Philadelphia were members of the clearing houses of the cities in which they were located. To that extent the independence of the Treasury had been abandoned. From the establishment of the Federal Reserve Banks there was a rapid evolution of a new policy on the part of the Treasury. The twelve Reserve Banks were designated public depositaries some time after they were ready for business. In the twelve cities in which these banks were established all other government deposits were discontinued, except that in some cases Federal court funds and postmasters' funds remained where they had been previously kept.

But the use of the Federal Reserve Bank as a depositary involved an important change in the attitude of the Treasury in that these banks gave no collateral security for the funds held. Moreover, the funds were used by the Treasury as checking accounts; indeed, in some cases the Treasury received temporary advances of funds against an approaching issue of loan certificates, and so, for the first time since 1846, the Treasury became a bank depositor and borrower in the common acceptation of these terms. But this change of attitude in 1914 was cautious and incomplete. The major part of the public revenue and expenditure continued as before to pass through the subtreasuries. At the close of the fiscal year, June 30, 1916, the distribution of the general fund was as follows:

In Treasury offices......	$130,534,179.97
In Federal Reserve Banks	113,480,576.00
In national bank depositaries...............	62,833,774.43
In Philippine Treasury..	3,968,122.73

The foregoing statement takes no account of the great trust funds held and administered by the treasury.

EFFECT OF THE WAR

The event which established the necessity of the new policy was our own entry into the World War and the great financial operations which ensued. Soon after war was declared it came to be the general understanding that our chief contribution to the joint enterprise would be in the field of finance and supply. To this end measures were adopted for the handling of funds of unprecedented magnitude with the least possible friction. Immediately on the passage of legislation providing for the first Liberty Loan, steps were taken to correlate the banks of the country with the Treasury for most effective team work. By the middle of November, 1917, the number of national banks designated as public depositaries was raised from 518 to 1,903. State banks and trust companies were pressed into service and 1,343 of these were named as public depositaries. In the Treasury circular of May 29 it was provided not only that banks so designated should hold on deposit to the credit of the government the funds received by them in the sale of bonds, but also that, when the funds should be required from the banks, the transfer should be made by a draft against the balance carried by the depositary bank in the Federal Reserve Bank in favor of the account of the Treasury in the same Federal Reserve Bank. That is to say, payments on governemnt account should be made by use of the bank's credit and with no reduction of its stock of cash.

Not only were these rules applicable to receipts from the several Liberty Loans but also to receipts from income taxes and excess profits taxes, as well as from the sale of certificates of indebtedness which succeeded one another in rapid succession throughout the War and the following year. It was the custom of the Treasury to leave the credit as long as might be in the local depositary banks where it would serve the business community to the greatest possible degree, and require transfer to government account in the Reserve Bank only as it was actually needed, thence to be disbursed by government check. These transfers of credit were made ratably throughout the country —a certain percentage of the deposit on a specified date. The result of this policy was to make the depositary banks collection agencies of the government, while the Reserve Bank of each district became a disbursing agency to a degree unknown in the past. The effect of these operations on the distribution of the general fund at the end of the fiscal year 1917 is shown below:

In Treasury offices......	$107,662,952.07
In Federal Reserve Banks	300,671,632.42
In special depositaries...	783,922,959.51
In regular depositaries...	49,681,738.91
In Philippine Treasury..	2,081,409.76

In order to appreciate the effect of the new policy upon the business of the Federal Reserve Banks it is only necessary to remember that the ordinary disbursements of the Treasury rose from a total of 682 millions in 1913 to 15,365 millions in 1919. The premises of the Reserve Banks became scenes of the greatest activity. New and larger quarters had to be taken, branch banks were established, and the employed personnel grew from 920 at the end of 1916 to 9,459 at the end of 1919. In the same three years the number of

state banks admitted to membership grew from 37 to 1,481, and the gold reserve from 738 millions to 2,063 millions.

Changes Under Act of 1920

From this showing it may properly be inferred that the expansion involved in the transfer of the duties of assistant treasurers under the mandatory act of 1920 had already taken place before the act was passed. By the terms of the law a period of thirteen months was allowed for making the change. The Secretary of the Treasury was permitted to assign the duties of the assistant treasurers to the treasurer, the mints and assay offices and to the Federal Reserve Banks, in such manner as might in his opinion best promote the public interest. It was provided further that the Secretary of the Treasury might assign to the Federal Reserve Banks such rooms, vaults and equipment as might be needed, and the employes of the various subtreasuries should have preference in application for positions in other departments of the government. However, most of them were taken over by the Reserve Banks.

In order that the transfer of business might go forward with the least disturbance of routine the change was made by degrees. The subtreasury at Boston was closed on October 25, 1920, that at Chicago, November 3; New York, December 6; San Francisco, December 20; New Orleans, January 5, 1921; St. Louis, January 8; Baltimore, January 14; Philadelphia, February 3, and Cincinnati, February 10.

In the case of six of these cities the work was taken over by the Reserve Banks located there, but in New Orleans, Baltimore and Cincinnati the functions of the subtreasury were transferred to branches of Reserve Banks located in those cities. But functions of the Independent Treasury were not confined to banks and branches in the nine cities in which subtreasuries were to be found. By Treasury circulars issued August 30 and October 19, all the Federal Reserve Banks and their branches were definitely constituted fiscal agencies of the United States Treasury. The effect of this was to extend the facilities formerly available in only nine cities to thirty-five cities at the outset and to as many more as might be favored with a branch bank in the future.

One important duty of the subtreasuries had been to account for the special trust funds such as the gold coin held against United States notes, gold coin and bullion held against gold certificates, and the silver dollars held against silver certificates. The care of these funds was transferred to the Treasurer of the United States at Washington, to be assisted as may be desirable by the mints and assay offices.

Treasury Duties of Reserve Banks

The new duties now devolving upon the Reserve Banks are:

The receipt of gold coin and silver dollars for exchange; the receipt of United States notes, Treasury notes, gold and silver certificates, subsidiary and minor coin for redemption; the exchange of various forms and issues of money for others; the cancellation or cleaning of currency unfit for circulation; the receipt from depositary banks of internal revenue, customs, postal and other funds; the receipt of deposits from other than depositary banks for money payable to the government from many sources; the payment of United States interest coupons; the payment of checks and warrants drawn against the Treasurer, and the receipt of government funds for transfer to other points.

From what has been said it will be clear that the actual abandonment of the Independent Treasury did not greatly augment the work of the Reserve Banks. For example, on the date of transfer the bank at New York already held $11,298,000 of government deposits, while the subtreasury in that city, whose normal business was far greater than that of any other, held only $1,448,000. This sum was all in coin. The building was turned over to the use of the bank under a lease but the title remains in the government. In Minneapolis, where there was no subtreasury, the assumption of the new duties was not so easily effected. The vaults of the bank were not adequate to meet the new demands and outside vault space was rented. Moreover, the clerical staff was considerably enlarged. In San Francisco the entire staff employed in the subtreasury was taken over by the bank. The building was occupied under a lease and is used as a place of storage of coin, currency and bonds, and for the housing of such employes as are required for the custody and exchange of these bonds.

SIGNIFICANCE OF THE NEW POLICY

The importance of the change therefore consists not in the magnitude of the new enterprise which the Reserve Banks have undertaken but in the significance of it. For all this coin and currency, insofar as it belongs to the general fund, now becomes a part of the banking reserve of the country. Large disbursements of government funds will never again stimulate speculation on the stock exchanges nor will the collection of a great surplus of revenue cause a chill in the markets of staple products. By adjustments through the Gold Settlement Fund maintained by the Federal Reserve Board at Washington the Reserve Banks will be able to make the largest payments, collections and transfers without affecting the magnitude of the reserves at any point.

The Establishment and Scope of Branches of Federal Reserve Banks

By E. R. FANCHER
Governor, Federal Reserve Bank of Cleveland

THE establishment and operation of the Federal Reserve Banks and branches is the direct result of intensive research and study on the part of economists, financiers and statesmen regarding the inadequacy of the banking system of the United States as developed under the national banking system, established in 1863, remodeled by enactment of Congress in 1864, and patched up from time to time by more than sixty legislative amendments. The national banking system as it formerly existed, was supplemented by the state banks and trust companies created by state laws, all functioning independently or separately. The entire system passed through various so-called panics up to 1907, at which time the attention of the whole country was brought sharply to the inherent weaknesses of our banking and credit system, while the crisis of that year compelled definite action along remedial lines. The system had proved inadequate to cope with modern commercial needs. It failed to supply commerce and in-